No. 92-1310

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1992

ELIE J. BAGHDADY,

Petitioner,

vs.

LARRY D. SADLER, and MERRILL, LYNCH, PIERCE, FENNER, AND SMITH, INC.

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the District Court erred in denying Petitioner's request for a jury trial and ordering arbitration when there was a dispute of material fact as to whether the parties had agreed to arbitrate the claims in issue between them.

2. Whether the "manifest disregard" standard for vacating an arbitration award was properly applied in this case.

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PETITION FOR A WRIT OF CERTIORARI

Elie J. Baghdady, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the First Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals (App., *infra*, 1a-7a) is not a reported case.[1] The opinion of the District Court denying

1. Subsequent to the decision of the First Circuit, Respondents filed a motion for publication of the September 9, 1992 opinion, specifically reciting as one of the grounds the right of the District Court Judge to decide the need for a trial, jury or nonjury, under the Federal Arbitration Act, 9 U.S.C. § 4. As of this date, there has been no ruling on the motion.

Petitioner's request for vacating, modifying, or correcting the arbitration award and granting in part and denying in part Respondent's motion to confirm the arbitration award is attached. (App., *infra*, 9a-11a).

STATEMENT OF JURISDICTION

The Court of Appeals entered its judgment on September 9, 1992. (App., *infra*, 8a). A timely appliction to extend the time for docketing the case was granted on November 20, 1992. (App., *infra*, 12a). The jurisdiction of this court is invoked under 29 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

United States Arbitration Act:[2]

Section 3, 9 U.S.C. § 3

Section 4, 9 U.S.C. § 4

Section 10, 9 U.S.C. § 10

STATEMENT OF THE CASE

This case involves the enforceability of agreements to arbitrate disputes under Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77(1)(2), and whether Petitioner's demand for a jury trial under 9 U.S.C. § 4 was improperly denied based upon a dispute of material fact as to whether there was an arbitration agreement between the parties in the first instance.

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2. The text of these provisions is reproduced in full at (App., *infra*, 13(a) - 16(a)).

This case is a paradigm of the problems faced today by customers with substantial grievances against their stockbrokers. Petitioner Elie J. Baghdady ("Baghdady") suffered damages in the millions of dollars as a result of the wrongful conduct of Respondents Merrill, Lynch, Pierce, Fenner & Smith ("Merrill Lynch") and Larry D. Sadler ("Sadler") and his deceased former broker, John Voll ("Voll"). When Baghdady brought a *pro se* complaint against Respondents in the District Court, he was compelled to submit his claim to binding arbitration, even though he had never agreed to be bound by arbitration when the account in dispute was initiated. When Baghdady did go to arbitration, the arbitration panel found the Respondents liable, but then proceeded to issue an award that reflected a manifest disregard of well-known legal principles applicable to his case.

Then, when Baghdady sought to vacate the arbitration award in the District Court, he was told that the award would be upheld because the respondents had provided a "rational" explanation for the award, even though the Respondents had all but admitted in their District Court pleadings that the purported explanation of the arbitration award was factually erroneous. The District Court also ruled that it was Baghdady's burden to show that the arbitration award was irrational, but then refused out-of-hand to review the *undisputed* facts which Baghdady presented to show the District Court that the award was irrational.

A. Factual Background.

Petitioner will present only the salient facts leading up to his involvement with Merrill Lynch.

In July, 1981, Baghdady opened an account with Merrill Lynch's office in Boston, Massachusetts transferring his securities position from another brokerage firm. Merrill Lynch assigned the account the number 818-73322. (C.A. App. 751).

When Baghdady opened the account with the Boston office of Merrill Lynch, he was asked to sign a "Standard Option Agreement", which he did. The agreement contained a provision for mandatory arbitration of disputes. This agreement, however, never came into play because Baghdady's account with the Boston office of Merrill Lynch functioned as he expected it would. The Boston account remained open from April to November 3, 1981 when the account was terminated by mutual agreement.[3] *Baghdady never asserted any claim concerning his account at the Merrill Lynch office in Boston.* (C.A. App. 038-39).

In November, 1981, Baghdady searched for a broker who could develop an options strategy with a new different objective for him. At that time and in the course of that search, he met with Respondent Sadler, who was then the manager of Merrill Lynch's office in Burlington, Massachusetts, and with John Voll, who was then a broker in the Burlington office. Sadler and Voll recommended to Baghdady a conservative strategy with respect to his new objectives. After having these discussions with Sadler and Voll and hearing the strategy outlined, Baghdady decided in mid-December, 1981 to open a new account at the Burlington office. When Baghdady decided to bring his business to the Burlington office in December, 1981, it was his intent and express understanding that he was opening a *new* account. (C.A. App. 040-42). He was opening an account at a different branch, with different brokers, and with a different objective based on a new liability against his stock positions, and thus, requiring a different investment strategy than he had in his Boston account with Merrill Lynch. Merrill Lynch assigned his account with the Burlington office a new number — 822-55654. The account in Boston was closed out.

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3. As a result of discussions between Respondent's representatives and Petitioner, a letter was sent requesting that Baghdady take his account elsewhere, effectively terminating the contractual relationship. (NASD Hearings, November 1, 1990, Vol. 6, pp. 182-183).

Sadler, the manager at the Burlington office, who was Baghdady's only point of contact in opening the Burlington account, also viewed the Burlington account as a new account. (C.A. App. 055-56). The only relationship between the Boston and Burlington accounts was that the securities position in Baghdady's already terminated Boston account was transferred to the Burlington account, just as his Boston account had been started by transferring his securities position from another brokerage firm to his Boston account with Merrill Lynch.

Baghdady never signed an agreement to arbitrate disputes arising in his account (no. 822-55654) at the Burlington office. (C.A. App. 041). Nor was he told, nor did he understand or agree that the option agreement he had signed in July, 1981 for his account at the Boston office would be resurrected and apply to the account he opened in December, 1981 at the Burlington office. When he opened the Burlington account, neither Sadler nor Voll nor anyone else told him that Merrill Lynch deemed the option agreement from the Boston office to apply to his new account at the Burlington office. Likewise, Baghdady did not know that Merrill Lynch had altered the face of the option agreement he had signed, without his consent (by crossing out the old Boston account number 818-73322 and writing in the new Burlington account number 822-55654). (C.A. App. 040, 047). Baghdady did not know until after he had filed suit against Merrill Lynch in the federal court that Merrill Lynch took the position that the option agreement for his previously terminated Boston account applied to his *new* account in Burlington. (C.A. App. 041).

Unfortunately, things did not go well in the Burlington account. From the beginning, Sadler and Voll did not effect the strategy in the account that they had outlined for Baghdady. Indeed, the records of the account obtained from Merrill Lynch revealed numerous violations of securities laws, Respondent's own policies, falsified reports of the condition of Petitioner's account, and violations of federal regulations.

When Baghdady closed the account at Burlington, he had lost $1,432,248.91. (C.A. App. 418-422, 482). He had brought to Sadler and Voll a portfolio valued at $2,420,762.50, burdened only with a margin debt of $604,172.53 — in other words, an account worth $1,816,589.97 and capable of unlimited appreciation within the market. (C.A. App. 421). When he closed the account, it was worth $384,381.06, and saddled with restrictions that foreclosed any real chance of recovery. Specifically, when he closed the account, his stock was shackled with in-the-money call options with distant expiration dates, as well as a margin debt of $1,243,840.19 that exceeded minimum margin requirements, which in combination was shown to have doomed Petitioner's account to inevitable loss irrespective of whether the market value of the securities actually went up or down or remained unchanged.

As a result, Baghdady was ultimately forced to sell a substantial quantity of his stock, at a cost to him of $4,228,794.93. (The basis for this figure was explained in Baghdady's Arbitration Memorandum and appears in the Appendix at C.A. App. 293-96.)

B. The District Court Opinions.

Baghdady filed suit in the District Court on August 2, 1985, asserting violations of the federal securities laws, false and deliberate misrepresentation, and negligence, and claiming damages in the amount of $4,300,000.00. His claims arose out of the transactions in his securities account with the Merrill Lynch office in Burlington, Massachusetts. On November 1, 1985, the Respondents Merrill Lynch and Sadler moved for an order compelling arbitration of the matter. Baghdady vigorously opposed arbitration, contending that there was no arbitration agreement between him and Merrill Lynch concerning disputes arising from transactions in his account with Merrill Lynch in Burlington, Massachusetts. On April 2, 1987, after submissions of affidavits and briefs, the District Court granted the Respondents' motion and ordered Baghdady to arbitrate his claims. This order by

the District Court to arbitrate was done in contravention of 9 U.S.C. § 4. Baghdady noted an appeal of this order, but subsequently withdrew the appeal as premature.[4]

As ordered by the District Court, Baghdady filed a request for arbitration with the National Association of Securities Dealers on April 28, 1988. After a substantial delay, the case was assigned for hearing by a panel of arbitrators in Boston on September 19, 1990. On that day, and on six subsequent days, Baghdady and the Respondents presented witnesses, exhibits, and arguments in support of their respective positions. On February 26, 1991, the panel rendered their decision holding Merrill Lynch and Sadler liable to Baghdady, but awarding only the sum of $60,720.15.

On May 24, 1991, Baghdady filed a petition for vacation or correction of the arbitration award, alleging that the award reflected a manifest disregard of the law applicable to the dispute and contained an evident miscalculation by the arbitrators. Respondents opposed Baghdady's petition and moved for confirmation of the award. The parties submitted briefs, including references to the substantial arbitration record, which was made part of the record in the District Court. On January 14, 1992, the District Court denied Baghdady's petition and allowed Respondents' cross-motion to confirm. Baghdady then requested that the District Court formally consolidate that ruling with the Court's prior ruling compelling arbitration, so that the issues might

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4. Respondents attempted to argue in their brief filed in the First Circuit that Petitioner's appeal was untimely. Both Congress and this Court clarified this issue. Congress made it clear when it enacted 9 U.S.C. § 16(b)(2) that immediate appeals from orders compelling arbitration were prohibited. This enactment followed this Court's pronouncement in *Gulfstream Aerospace Corp. v. Mayacamas Corp.*, 485 U.S. 271 (1988). That decision declared that an appeal should be brought only after completion of the compelled arbitration. The First Circuit followed *Gulfstream* in *DeFuertes v. Drexel Burnham Lambert, Inc.*, 855 F.2d 10 (1st Cir., 1988).

be appealed together to the First Circuit Court of Appeals. On January 27, 1992, the District Court consolidated the actions and entered final judgment.

C. The Court Of Appeals' Opinion.

The Court of Appeals' opinion affirmed the District Court's order confirming the arbitration award. The Court of Appeals held that the language in the agreement executed between the parties pertaining to the Boston account also applied to the Burlington account and was clear and was binding and that Petitioner was not entitled to a jury trial.

The Court of Appeals rejected Petitioner's reliance upon *Par-Knit Mills, Inc. v. Stockbridge Fabrics Co., Ltd.*, 637 F.2d 51 (3rd Cir. 1980) which suggested that if there was a doubt to an express, unequivocal arbitration agreement, the matter, upon proper and timely demand, should be submitted to a jury. In the instant case, Petitioner had, in fact, requested on a timely basis a jury demand, which the District Court rejected without any determination and fact finding.

The Court of Appeals completely refused out-of-hand to review the facts and assertions in Baghdady's complaint and affidavit in opposition to the Respondents' motion to compel arbitration. Essentially, Petitioner's arguments contending that there were never any agreements binding him to Respondents to arbitrate any of his claims was totally rejected. The Court of Appeals also rejected the "manifest disregard" arguments presented by Baghdady *citing Advest, Inc. v. McCarthy*, 914 F.2d 6 (1st Cir. 1990).

REASONS FOR GRANTING THE WRIT

1. The petition should be granted because the Court of Appeals failed to follow this Court's decision in *Prima Paint Corporation v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1961) which held tht a federal court may consider issues relating to the making and performance of the agreement to arbitrate if there is a claim of fraud in the inducement of the arbitration clause in issue.

2. The writ should also be granted because the Court of Appeals' decision conflicts with another Court of Appeals' decision in *Par-Knit Mills, Inc. v. Stockbridge Fabrics Co., Ltd.*, 636 F.2d 51 (3rd Cir. 1980), as well as numerous other federal court decisions.

3. This Court should enunciate a manifest disregard standard.

I.

THE FEDERAL POLICY FAVORING ARBITRATION SHOULD NOT APPLY IN CASES WHERE FACTS ALLEGING FRAUD ARE ASSERTED AND WHERE A TIMELY DEMAND FOR JURY TRIAL IS REQUESTED UNDER 9 U.S.C. § 4.

A. The Statutory Right To A Trial Pursuant To 9 U.S.C. § 4 Should Not Be Undermined And Further Eroded.

There is no question that federal law generally favors arbitration. This Court has recently stated that:

> Section 2 [of the United States Arbitration Act] is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary. . . .

Moses H. Cone Mem. Hosp. v. Mercury Construction Corp., 460 U.S. 1 at 21 (1983). *See also, Southland Corp. v. Keating*, 465 U.S. 1 (1984).

Nevertheless, this Court has acknowledged that the Arbitration Act of 1925 was enacted to make agreements to arbitrate future disputes "as enforceable as other contracts, but not more so". *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404, n. 12 (1967). This Court has also recognized the drawbacks of arbitration. *Bernhardt v. Polygraphic Company of America, Inc.*, 350 U.S. 198 (1955). Against the benefits of the informality of arbitration, dispatch and finality must be weighed the disadvantages of limited review, the possibilities of arbitrary and capricious results at the hands of untrained and possibly biased arbitrators, and the absence of any definite rule of law, any record, or any requirement that the arbitrators articulate the factual and legal conclusions tht underlie the award. *Hale v. Friedman*, 281 F.2d 635 (D.C. Cir. 1960).

In the context of a freely negotiated contract between parties of equal bargaining power there may be no unfairness in enforcing an arbitration provision despite the inherent shortcomings of arbitration. However, to force arbitration on an individual who did not execute an agreement and knowingly bargain away the right to a judicial forum is patently unfair:

> The right to select judicial forum, vis-a-vis arbitration, is a "substantial right", not lightly to be deemed waived.[5]

B. Standard Of Review And Applicable Law.

The critical issue reduced to its simplest form is whether Baghdady's claim of fraud relates to the making of the arbitration

5. *Main v. Merrill, Lynch, Pierce, Fenner & Smith*, 67 Cal. App. 3rd 19, 31, 136 Cal. Rptr. 378, 383 (1977).

agreement. If it does, the court should adjudicate the fraud claim. If it does not, the Federal Arbitration Act requires that the fraud claim be decided by an arbitrator. In the present case, there was a factual dispute whether there was an agreement to arbitrate Petitioner's claims. The District Judge erroneously resolved the factual dispute without holding any trial, let alone a jury trial, as required by 9 U.S.C. § 4. This is clearly exemplified in the following actual disputes:

1. When faced with Petitioner's affidavit that he did not intend or understand that the option agreement he signed when he opened his account in Boston would apply to his account in Burlington (C.A. App. 36), as opposed to Respondent's representative's affidavit who was not even involved in the opening of the Burlington account preventing conflicting testimony that Merrill Lynch did intend the agreement to apply to the Burlington account (C.A. App. 32), the District Judge simply sided with Respondents, rather than submitting the issue to a jury, as 9 U.S.C. § 4 requires.

2. When faced with the Respondent's "new account" form (C.A. App. 9) describing the Burlington account as both a "new account" (Terminology that was admitted to by Respondent Sadler himself [C.A. App. 17]) and, arguably, as a "transferred" account, the lower court judge resolved all inferences in support of arbitrability, rather than submitting the issue to a jury, as 9 U.S.C. § 4 requires.

3. When faced with the fact that there was no signed arbitration agreement for the Burlington account (C.A. App. 41), the District Judge drew the inference that the parties

> intended a prior agreement to apply to the account, rather than allowing a jury to draw the obvious contrary inference that the absence of a signed arbitration agreement for the Burlington account evidenced that the parties did not agree to arbitration of the disputes in the Burlington account.

The standard of review for a motion to compel arbitration is the same as a motion for summary judgment under Fed. R. Civ. P. 56(c). *Trott v. Paciolla*, 748 F. Supp. 305, 308 (E.D. Pa. 1990); *Par-Knit Mills, Inc. v. Stockbridge Fabrics Co.*, 636 F.2d 51, 54, n. 6 (3rd Cir. 1980). Accordingly, "the moving party has the burden of showing *conclusively* that there exists no genuine issue as to a material fact, and the evidence, together with all inferences to be drawn therefrom, must be read in a light most favorable to the party opposing the motion". *Jordan v. Global Natural Resources, Inc.*, 564 F. Supp. 59, 63 (S.D. Ohio, 1983) (emphasis in original). Indeed, the court must read the allegations in plaintiff's complaint "liberally, giving plaintiff the benefit of all inferences which fairly may be drawn therefrom". *Begosian v. Gulf Oil Corp.*, 561 F.2d 434, 444 (3rd Cir. 1977).

The party opposing arbitration bears the initial responsibility of presenting the court the basis for its opposition. This burden is not unlike that of a party opposing summary judgment. *Celotex Corporation v. Catrett*, 477 U.S. 317 (1986).

Pursuant to Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2, agreements to arbitrate are valid "save upon grounds as exist at law or in equity for the revocation of any contract". Based on this section, numerous courts have determined that a party may assert general contract defenses such as fraud and/or breach of contract to avoid enforcement of an arbitration agreement. *Southland Corp. v. Keating*, 465 U.S. 1 (1984); *see also, Hurlburt v. Gantshar*, 674 F.

Supp. 385 (D.C. Mass. 1987) (party may assert general contract defenses to avoid enforcement of arbitration agreement).

Indeed, the federal courts are required to adjudicate claims where they are directed towards the validity or enforceability of an arbitration clause within a contract (as opposed to the entire contract). *Leone v. Advest, Inc.*, 624 F. Supp. 297 (S.D.N.Y. 1985). As this Court ruled in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), any defense to a contract which is applicable to an arbitration provision within the contract so as to render that provision invalid, is sufficient to place this case before the court, not a panel of arbitrators.

In *Prima Paint, supra,* the parties signed a written agreement by which Prima purchased Flood's paint manufacturing business and retained Flood's services as a consultant. The agreement included a clause calling for arbitration of any controversy or claim arising out of or in relation to this agreement, or the breach thereof. Shortly after the execution of the agreement, Flood filed for bankruptcy. When Prima complained that Flood had fraudulently induced Prima to enter into the purchase and consulting agreements on the false representation that Flood was solvent, Flood promptly demanded that the dispute be arbitrated. Prima then filed suit in the federal district court seeking rescission of the consulting agreement on the basis of the alleged fraudulent inducement and contemporaneously sought an order restraining Flood from proceeding with the arbitration.

As this Court in *Prima Paint* held: "If the claim is fraud in the inducement of the arbitration clause itself — an issue which goes to the 'making of the agreement to arbitrate' — the federal court may proceed to adjudicate it." 388 U.S. at 403-04. This Court in *Prima Paint* found its holding consistent with the decision in *Mosely v. Electronic Facilities,* 374 U.S. 167 (1963), and with the statutory purpose of the Arbitration Act — to make arbitration

agreements as enforceable as other contracts. 388 U.S. at 404, n. 12. In *Moseley*, this Court held that where a plaintiff's pleading attacks the contract in general, as well as the arbitration clause contained therein, the allegation of fraud as to the arbitration clause should be decided by the District Court. 374 U.S. at 171.

In interpreting *Prima Paint*, the lower court in *Rhoades* v. *Powell*, 644 F. Supp. 645, 653 (E.D. Cal. 1986), held:

> The *Prima Paint* holding can be reduced to the fairly simple proposition that a challenge based on fraud in the inducement of the whole contract (including the arbitration clause) is for the arbitrator to decide, while a challenge based on fraud in the inducement of the arbitration clause only is for the court to decide.
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> * * *
>
> The *Prima Paint* doctrine is not limited, however, to rescission based on fraudulent inducement, but extends to all challenges to the making of a contract: "The teaching of *Prima Paint* is that a federal court must not remove from the arbitrators consideration of a substantive challenge to a contract unless there has been an independent challenge to the making of the arbitration clause itself. The basis of the underlying challenge to the contract does not alter the [*Prima Paint*] principle." *Unionmutual Stock Life Insurance v. Beneficial Life*, 774 F.2d 524, 529 (CA 1, 1985) (frustration of purpose as ground for rescission); *Hull v. Norcom*, 750 F.2d 1547,

> 1549-50 (CA 11); *reh'g denied,* 757 F.2d 287 (1985) (challenge based on lack of mutuality of arbitration clause); *Merrill Lynch v. Haydu,* 637 F.2d 391 (CA 5, 1981) (duress and unconscionability to be decided by arbitrator).

Here, Respondents failed to meet the standard required to divest the District Court of jurisdiction over the case by failing to establish the absence of material facts with respect to the validity or enforceability of the arbitration provision in the "Standard Option Agreement". *Moreover,* the challenge was based on asserted facts that there was no agreement to arbitrate in the first instance.

Respondents have essentially argued that Petitioner did not create "a substantial issue" regarding the validity of the arbitration clause. A party opposing a motion to compel arbitration has the "affirmative duty of coming forward by way of affidavit or allegation of fact to show why the Court should not compel arbitration". *Aronson v. Dean Witter Reynolds, Inc.,* 675 F. Supp. 1324, 1325 (S.D. Fla. 1987). Consistent with the *Aronson* holding is the opinion of the recent case of *Arnold v. Arnold Corp.,* 920 F.2d 1269 (6th Cir. 1990). In *Arnold,* the appellant argued that the District Court erred when compelling him to arbitrate his claim, arguing that he had sufficiently alleged fraud in the inducement with respect to the arbitration provision of the contract. In rejecting the appellant's contentions and in affirming the lower court's order compelling arbitration, the Sixth Circuit noted:

> Before a court may adjudicate an agreement to arbitrate, the party seeking to avoid the arbitration must make "a well-founded claim that an arbitration agreement resulted from the sort of fraud or excessive economic power" that would provide grounds for the revocation of a contract.

> *Arnold*, 920 F.2d at 1277, *quoting Shearson/ American Express, Inc. v. McMahon*, 482 U.S. 220, 226, 106 S. Ct. 2332, 2337 (1987).

Petitioner claims that his submissions clearly nullified the right of the District Court to compel arbitration.

This Court's holding in *Prima Paint* left the door open for a person challenging arbitration to recite well-founded allegations of fraud in connection with the "making" of an agreement to arbitrate. This Petitioner accomplished in his affidavit in response to Respondents' motion to compel arbitration.[6]

C. The First Circuit Decision In The Instant Case Conflicts With The Third Circuit Opinion Of *Par-Knit Mills v. Stockbridge Fabrics.*

The Third Circuit, in *Par-Knit Mills v. Stockbridge Fabrics*, 636 F.2d 51 (3rd Cir. 1980), was faced with a situation similar to the case at bar. The Third Circuit characterized the plaintiff's position as follows:

> Par-Knit claims that there was never a "meeting of the minds" on the terms and conditions contained in the confirmations which were signed by its production manager and which contained an arbitration agreement and that absent such agreement, there can be no duty to arbitrate.

Id. at 53.

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6. At the arbitration hearings, Petitioner argued that the agreement to arbitrate had been "tampered" with. A contract induced by fraud is voidable. Claims of forgery or "tampering" are distinguishable. Forgery relates to fraud in the execution, and contracts involving forgery are void. *See Dougherty v. Mieczkowski*, 661 F. Supp. 267, 274 (D. Del. 1987).

In reversing the District Court's order compelling arbitration, and ordering that the issue as to whether there was an arbitration agreement be tried before a jury pursuant to Section 4, the Third Circuit said:

> Before a party to a lawsuit can be ordered to arbitrate and thus be deprived of a day in court, there should be an express, unequivocal agreement to that effect. If there is doubt as to whether the agreement exists, the matter, upon a proper and timely demand, should be submitted to a jury . . . *The district court, when considering a motion to compel arbitration which is opposed* on *the ground that no agreement to arbitrate has been made between the parties, should give to the opposing party the benefit of all reasonable doubts and inferences that may arise.*

Id. at 54 (emphasis added).

The Third Circuit in *Par-Knit* recognized that the general policy of favoring arbitration could be undermined if it was too easy to invoke the Section 4 right to a jury trial on the issue of whether there is an applicable arbitration agreement. Hence, the court ruled as follows:

> A naked assertion, however, by a party to a contract that it did not intend to be bound by the terms thereof is insufficient to place in the issue "the making of the arbitration agreement" for the purposes of Section 4 of the Federal Arbitration Act. An unequivocal denial that the agreement had been made, accompanied by supporting affidavits, however in most cases

> should be sufficient to require a jury determination on whether there had in fact been a "meeting of the minds".

Interocean Shipping Co. v. National Shipping & Trading Co., 462 F.2d 673 (2nd Cir. 1972).

Id. at 55.

The *Par-Knit* Court said that the standard to be applied in determining whether to hold a Section 4 jury trial is the summary judgment standard, which requires the court to accept as true the affidavits of the party opposing the motion. Obviously, the District Court in the instant case did not give Petitioner the benefit of the doubt. Not only did it not assume that Petitioner's affidavit was true, it *ignored* the affidavit.

Petitioner fully met the above quoted *Par-Knit* standard. The District Court erred in not holding a trial on the fundamental factual question of whether there was a meeting of the minds between Petitioner and Respondents to arbitrate disputes arising from his account.

The premise on which a court can order arbitration is the existence of such an agreement. If no agreement or contract exists, there is no right to arbitration. *See Dougherty v. Mieczkowski*, 661 F. Supp. 267 (D. Del. 1987).

Other courts have followed the admonitions recited by this Court in *Prima Paint* and *Mitsubishi* and advanced in *Par-Knit*. *See Woodyard v. Merrill, Lynch, Pierce, Fenner & Smith*, 640 F. Supp. 760 (S.D. Tex. 1986); *CBS Employees Federal Credit Union v. Donaldson, Rufkin & Jenrette Securities Corp.*, 912 F.2d 1563 (6th Cir. 1990).

The Court of Appeals in this case completely missed the issue

raised by Petitioner that there was no contract between the parties. In *Dougherty v. Mieczkowski, supra,* as in the instant case, the uncontroverted affidavit of the plaintiff contending the documents were "doctored" mandated a trial pursuant to 9 U.S.C. § 4.

II.

THE FEDERAL POLICY UPHOLDING ARBITRATION SHOULD NOT UNDERMINE THE VITALITY OF 9 U.S.C. § 4 AND SHOULD BE MODIFIED TO PROTECT INVESTORS WHO CLAIM FRAUD.

A. Further Erosion Of The Principles Of *Prima Paint* As Reflected In The FAA Should Cease.

In the ensuing years after *Prima Paint*, this Court has rendered decisions in a number of cases upholding a strong federal policy in favor of arbitration. In *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983), this Court stated, "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability". *Id.* at 24-25; *see also, Dean Witter Reynolds, Inc. v. Byrd,* 470 U.S. 213 (1985) (Arbitration Act requires district court to compel arbitration of pendant arbitrable claims); *Mitsubishi Motors Corp.*, 473 U.S. 614 (1985) (anti-trust claims subject to arbitration); *McMahon,* 482 U.S. 220 (1987) (Securities Exchange Act of 1934 & RICO claims subject to arbitration); *Rodriquez de Ouijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989) (claim arising under Securities Act of 1933 subject to arbitration, overruling this Court's prior holding in *Wilko v. Swan,* 346 U.S. 168 (1953)); *Gilmer v. Interstate Johnson Lane Corporation,* 500 U.S. __, 114 L. Ed. 2d 26 (1991) (claim under age discrimination in Employment Act held to be subject to compulsory arbitration.)[7]

7. As Justice Stevens in Gilmer pointed out, this Court "has effectively rewritten the statute", referring to the FAA. (500 U.S. at __, 114 L. Ed. 2d at p. 48).

B. The Last Stand For The Investors — This Court Should Level The Playing Field.

Subsequent to this Court's 5 to 4 decision in *Rodriguez de Quijas v. Shearson/American Express*, 490 U.S. 477 (1989), the right of the investing public to challenge the validity of arbitration agreements was effectively wiped out. The current state of the law requires federal security law claims to be arbitrated. Both the *McMahon* and *Rodriguez* decisions open the door to mandatory arbitration as a universal practice in the securities industry, which had never been the intent of Congress.[8]

The only remaining door to a challenge to break through the wall mandating arbitration that has been built by this Court is to recall the admonitions recited in *Wilko*, *Prima Paint*, and *Mitsubishi*. In all of these cases, this Court correctly noted a theme that still remains vital today:

> Accordingly, the first task of a court asked to compel arbitration of a dispute is to determine whether the parties agreed to arbitrate that dispute. The court is to make this determination by applying the "federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the act".

Mitsubishi Motors v. Soler Chrysler-Plymouth, 473 U.S. at 626.

And, it has also been stated:

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8. As Justice Stevens in *Rodriguez* said: "we, of course, are not subject to the same restraint when asked to upset one of our own precedents. but when our earlier opinion gives a statutory provision concrete meaning, which Congress elects not to amend during the ensuing three and half decades, our duty to respect Congress' work product is strikingly similar to the duty of other Federal courts to respect our work product". (490 U.S. at 486).

> Of course, courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds "for the revocation of any contract".

Mitsubishi Motors v. Soler Chrysler-Plymouth, 473 U.S. at 627.

Lower courts have established the reasons why this Court should be diligent in prohibiting fraud to go unchecked by judicial scrutiny. In *Woodyard v. Merrill, Lynch, Pierce, Fenner & Smith*, 640 F. Supp. 760 (S.D. Tex. 1986), the court indicated that the case:

> presented a classic example of an unsophisticated investor who has sought, received, and relied upon the superior knowledge of a securities advisor. Upon entering the relationship of trust, it is understandable that the customer's adversarial instincts would be lulled. Thus, equitable principles leave little space for the subsequent operation of the doctrine of *caveat emptor*. At the very least, pre-dispute arbitration agreements between brokers and their public customers should remain subject to meaningful judicial inquiry. There is a potential for conflicts of interest when investors marketplace intermediary, upon entering a fiduciary relationship, has one unilateral, adversarial eye cocked upon possible litigation between the parties to a standarized brokerage contract.

640 F. Supp. at 766.

It has been stated in numerous commentaries that the playing field at the present time is not level. The brokerage houses have it all their way. Arbitration may be mandatory, but it is not fair.[9] The reasons for this are numerous. The panelists are representatives of the securities industry. The brokerage firms and their attorneys know the ins and outs and exchange information not presently available to investor litigants. The rules are set by the securities industry. Discovery is limited. The primary problem is the lack of an effective right to an appeal. Arbitration will never be accepted unless the public perceives that the arbitration process is fair in fact and appearance. This is certainly not the case where an investor, such as the Petitioner in this case, receives less than 5 percent of his provable claims!

The underlying philosophy of the securities arbitration process, as is presently structured, is not equally appropriate for both litigants. The basic problem is the standard upon which arbitrators base their decision. The current uncertainty regarding the standard that should guide arbitrators is another reason for this Court to grant the writ and to set out and develop a guideline to balance the playing field between the brokerage houses and the investing public.

III.

A UNIFORM STANDARD FOR VACATING ARBITRATION AWARDS SHOULD BE ESTABLISHED BY THIS COURT.

A. The Standard For Vacating Of An Arbitration Award.

Section 10 of the Federal Arbitration Act, 9 U.S.C. § 10 provides in pertinent part:

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9. *See* Robert R. Gregory, *Arbitration: It's Mandatory But It Ain't Fair,* 19 Sec. Reg. L.J. 181 (1991).

> The United States court in and for the district wherein [an arbitration] award was made may make an order vacating the award upon the application of any partly to the arbitration. . . .
>
> Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

In addition, this Court has recognized the non-statutory ground of "manifest disregard of the law" as an additional basis for vacating arbitration awards. *See Wilko v. Swan*, 346 U.S. 427, 436-37 (1953). This standard has been applied by numerous courts around the country, including the First Circuit. *See, e.g., Advest, Inc., v. McCarthy*, 914 F.2d 6 (1st Cir. 1990); *Merrill Lynch, Pierce, Fenner & Smith v. Bobker*, 808 F.2d 930, 933 (2nd Cir. 1986).

The *Bobker* court explained the standard of manifest disregard of the law as requiring "more than error or misunderstanding with respect to the law". 808 F.2d at 933. It requires: (1) an error that would be "readily and instantly perceived" by a typical arbitrator; and (2) that the arbitrator was aware of the proper legal standard but proceeded to disregard it in fashioning the award." *Id.* Awareness of the proper legal standard need not be explicitly stated, but may be inferred. *Id.* As the First Circuit explained in *Advest*, "the governing law may have such widespread familiarity, pristine clarity, and irrefutable applicability that a court could assume the arbitrators knew the rule and, notwithstanding, swept it under the rug". 914 F.2d at 10. The court in *Bobker* acknowledged that the bounds of the standard have never been interpreted to require something "more than error or misunderstanding with respect to the law". *Id.* The Second Circuit in *Bobker* found that under the "manifest disregard" standard:

> The arbitrator's error must have been obvious

> and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator. Moreover, the term "disregard" implies that the arbitrator appreciates the existence of a clearly governing legal principle but decides to ignore or pay no attention to it.

808 F.2d at 933.

As so interpreted, the "manifest disregard" standard does not require arbitrators to strictly comply with the law. This interpretation merely requires that arbitrators not flaunt the law. The implication of the language used by the *Bobker* court in analyzing the "manifest disregard" standard would seem to be that arbitrators can base their awards on whatever grounds they choose as long as the result is not obviously in conflict with the outcome that would be required by law.

The strict interpretation of the "manifest disregard" standard was suggested by this Court in *Wilko* and *McMahon*. That standard has not been followed in numerous federal decisions.

The Ninth Circuit in *San Martine Compania De Navegacion v. Saguenay Terminals Ltd.*, found that "manifest disregard of the law must be something beyond and different from a mere error in the law or failure on the part of the arbitrators to understand *or apply* the law". The court in *San Martine* decided that manifest disregard "might be present when arbitrators understand and correctly state the law, but proceed to disregard the same". The requirement that arbitrators must understand the law, correctly state it, and then reject it before a court will find "manifest disregard" of the law was also adopted by the Second Circuit in *Siegel v. Tital Industries Corp.*, 779 F.2d 891 (2nd Cir. 1985). Thus, the Ninth and Second Circuits have applied an interpretation of the manifest disregard

standard that does not so much require arbitrators to comply with applicable law as it requires arbitrators merely not to ignore the law when it is understood. This interpretation is a curious analysis of the "manifest disregard" standard. The interpretation suggests that if an arbitrator does not understand the applicable law, he need not apply it. Such an interpretation might place a premium on an arbitrator's ability to remain ignorant of the law. Pursuant to this interpretation, without an understanding of the law, there cannot be disregard of the law.

B. This Court Should Modify The Standard Set Forth In *Advest* In Order To Deny Confirmation To Arbitration Awards That Lack Any Rational Basis Or Otherwise To Prevent The Miscarriage Of Justice In Cases Such As The Instant Case.

As explained above, the District Court construed the manifest disregard test set forth in *Advest, Inc. v. McCarthy*, 914 F.2d 6 (1st Cir. 1990), to preclude review of factual matters. Petitioner maintained that the manifest disregard test must include some consideration of facts in that the court must assess how the arbitrators in a case have applied the law to the facts and expecially to undisputed facts. The Petitioner requested that the First Circuit, if it concluded the District Court's interpretation of *Advest* was correct, that they modify the *Advest* test to include consideration of how the law was applied to the facts or otherwise to avoid a miscarriage of justice in cases such as this. The First Circuit refused to modify *Advest*.

There is ample precedent from other jurisdictions interpreting the manifest disregard standard to include consideration of both law and facts.[10] Perhaps the most common interpretation requires a

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10. Indeed, the First Circuit's opinion in *Advest* has specifically been criticized for its failure to incorporate a rational basis analysis. *See* S. Kupperman & G. Freeman, *Achieving Justice in Arbitration*, 65 Tulane L. Rev. 1547 (1991).

court to determine whether there is any "rational basis" for the award. This test was described by the Eleventh Circuit as follows in *Robbins v. Day*, 954 F.2d 679, 684 (11th Cir. 1992):

> When no rationale is given for a lump sum award, as in this case ... we must first determine whether a rational ground for the arbitrators' decision can be inferred from the facts of the case. Where a "ground for the arbitrator's decision can be inferred from the facts of the case, the award should be confirmed". *Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 903 F.2d 1410, 1413 (CA 11, 1990) (citing *Siegel v. Tital Indus. Corp.*, 779 F.2d 891, 894 (CA 2, 1985) (quoting *Sobel v. Hertz, Warner & Co.*, 469 F.2d 1211, 1216 (CA 2, 1972); *Drummon Coal Co. v. United Mine Workers of Am*, 748 F.2d 1497 (CA 11, 1984) (cited by *Raiford* for the proposition that an arbitration award may be vacated if irrational); *Barbier v. Shearson Lehman Hutton, Inc.*, 948 F.2d 117 (CA 2, 1991).

954 F.2d at 684.

The *Robbins* court went on to explain that the burden of proving a lack of rational basis falls on the party seeking vacation of the arbitration award: "The onus is on the party requesting the vacatur to refute . . . every rational basis upon which the arbitrator could have relied." *Id.*

Obviously, the burden outlined in *Robbins* is a very high one, but it was met in this case. As set forth above, Petitioner carefully refuted all possible reasons for which the arbitrators could have determined to award him losses on only two out of twenty-five

margin transactions. The one justification for this calculation, offered up by Respondents, is contradicted by the arbitration record and was all but conceded by Respondents below.

Another formulation of the "rational basis" test that has been adopted by several courts incorporates the "arbitrary and capricious" standard developed in the administrative law context. The Eleventh Circuit applied this test in *United States Postal Service v. National Association of Letter Carriers*, 847 F.2d 775 (11th Cir. 1988), where it observed:

> While great deference is normally accorded an arbitration award, an award is not required to be enforced which is arbitrary or capricious. *See, Drummon Coal Co. v. United Mine Workers of Am*, 748 F.2d 1495, 1497 (CA 11, 1984) (citing *Loveless v. Eastern Air Lines, Inc*, 681 F.2d 1272, 1276 (CA 11, 1982); *United Steelworkers of Am v. US Gypsum Co.*, 492 F.2d 713, 730 (CA 5), *cert denied*, 418 US 998 (1974); *Safeway Stores v. Am Bakery & Confectionary Workers Int'l Union, Local 111*, 390 F.2d 79, 81 (CA 5, 1968).

Petitioner urges the Court to adopt the "arbitrary and capricious" standard for which there is a well-developed jurisprudence.[11] Application of this test in the present case would

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11. The use of this standard is warranted because it accords great deference to those hearing a case as an initial matter. In the administrative context, great deference is due because the initial decision-maker, the administrative agency, has special expertise and statutorily-mandated responsibility to make the initial decision. *See El du Pont de Nemours & Co. v. Collins*, 432 U.S. 46, 54-55 (1977). In the arbitration context, great deference is due because of the strong legislative preference for resolving disputes through arbitration. *See OR Securities v. Professional Planning Assoc.*, 857 F.2d 742, 747-48 (11th Cir. 1988).

have required vacation of the arbitrators' award. In light of the arbitrators' finding that Respondents were liable to Petitioner and the undisputed evidence of damages presented by him, an arbitration award that excluded 95 to 99 percent of his undisputed damages is "arbitrary and capricious", at best.

In the alternative, Petitioner submits that this Court should interpret "manifest disregard of the law" to encompass the familiar standard used in ruling on motions to set aside jury verdicts. Under that standard, courts have set aside a civil jury award "when the verdict is against the clear weight of the evidence . . . or will result in a clear miscarriage of justice". *Torres-Troche v. Municipality of Uaco*, 873 F.2d 499 (1st Cir. 1989) [*quoting Coffran v. Hitchcock Clinic, Inc.*, 683 F.2d 5, 6 (1st Cir.), *cert. denied*, 459 U.S. 1987 (1982)].

Thus, for example, in the recent case of *Phav v. Trueblood, Inc.*, 915 F.2d 764 (1st Cir. 1990), the District Court for the District of Massachusetts set aside a jury award of $5,000.00 in the face of clear evidence that the plaintiff's damages were far more than that amount. Upon retrial, the plaintiff was awarded $370,000.00, and the judgment was affirmed on appeal. *See also, Brown v. Richard A. Wacholz, Inc.*, 467 F.2d 18 (10th Cir. 1972) (to the same effect).

As with the "arbitrary and capricious" standard, the use of this test is appropriate because it accords great deference to the intial trier of fact. The test is triggered only in cases where there is an enormous discrepancy between the evidence presented and the result ordered, or where the result would effect a "miscarriage of justice". Petitioner respectfully submits that the review of arbitration awards in all Circuits should function under the same standard to prevent grossly unjust results.

The difficulty in demonstrating bias or arbitrary and capricious conduct undermines the rights of investors and leaves

them without any meaningful standard upon which to challenge arbitration awards. However, the lack of a proper basis for an arbital decision is not to be overlooked and should arouse a court's suspicion when the award is less than a minimal percentage of the undisputed losses of an investor.

In *Tinaway v. Merrill Lynch & Co.*, 658 F. Supp. 567 (S.D.N.Y. 1987), the court held that an arbitration panel's award of 5 percent of an investor's documented loss in the absence of some stated basis could "only represent 'evident impartiality' on the part of the arbitrators". (658 F. Supp. at 579).

In this case, we have exactly that situation. A *de minimus* amount was awarded which Petitioner claims shows evident partiality requiring reversal.

Since there is limited review of arbitration proceedings, the appeal by Justice Blackmun in *McMahon* must not be taken lightly. This Court should take seriously the duty to review the results of arbitration in which there is manifest disregard of the law.

Petitioner lost millions of dollars as a result of Respondents' wrongful conduct. Although he did not agree to arbitrate, he went to arbitration and proved that Respondents caused these losses. He presented undisputed evidence of negligence, falsification of records, violation of trust and governing rules and federal regulations and obtained a finding of liability against Respondents. Then, at the end of the line, he was presented with an award, lacking any rationale, that does not even begin to compensate him for his undisputed substantial losses. This is a miscarriage of justice, if there ever was one, and this Court must now allow it to stand even under the strictest level of review. This Court should clearly enunciate a standard for manifest disregard for all investors who will be protected in the arbitration process.

CONCLUSION

This Court should grant the petition for a writ of certiorari. There is a split in the Circuits on the issue of the entitlement to a jury trial under factual circumstances where fraud is alleged. With respect to issues involving claims under Section 12(2) of the 1933 Securities Act where there is a previously terminated arbitration agreement which is resurrected and tampered with and becomes the basis of the alleged enforceability of an arbitration agreement and there is a dispute as to the validity and actual execution of this agreement, such issues are not for arbitration and must be decided by the District Court.

Moreover, the First Circuit's "manifest disregard" standard conflicts with that enunciated by this Court and other Circuits. Also, this Court needs to come to the aid of investors and prevent further erosion of rights delineated under 9 U.S.C. § 4.

Based on all of the foregoing reasons, the judgment of the United States Court of Appeals for the First Circuit should be reversed and Petitioner's Section 12(2) claims under the 1933 Securities Act ordered tried in the Federal District Court.

Respectfully submitted,

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Dated: February 2, 1993

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT DATED SEPTEMBER 9, 1992

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 92-1214

ELIE J. BAGHDADY,

Plaintiff, Appellant,

v.

LARRY D. SADLER, ET AL.,

Defendants, Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

[Hon. Joseph L. Tauro, *U.S. District Judge*]

Before

Cyr and Boudin, *Circuit Judges*,
and Hornby,* *District Judge*.

Edward F. Haber with whom *Andrew A. Rainer* and *Spairo, Grace & Haber* were on brief for appellant.

Bryan G. Killian with whom *David A Guberman, Barbara O'Donnell* and *Sherin and Lodgen* were on brief for appellees.

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* Of the District of Maine, sitting by designation.

Appendix A

September 9, 1992

HORNBY, *District Judge*. This appeal challenges a decision compelling arbitration of a dispute between a securities firm and a customer, and the eventual confirmation of the arbitrator's award. The record satisfies us that there was an enforcable agreement between the parties to arbitrate disputes. We therefore conclude that the lower court properly compelled arbitration under the Federal Arbitration Act, 9 U.S.C. §§ 1-16. Because the challenge to the award reveals only frustration with the results, there is no basis to vacate the district court's decision to confirm the award. We therefore affirm.

Facts

Elie J. Baghdady held a substantial number of shares in a company called Teledyne, Inc. ("Teledyne"). Unhappy with the handling of his securities account at another brokerage firm, in July, 1981, Baghdady transferred his Teledyne shares to the Boston office of merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch"). According to Baghdady, he opened the Merrill Lynch account for the single purpose of containing risks he was facing on certain call options. He expected the arrangement to last only until he could find a broker with sufficient "expertise in options to help him out of [his] precarious investment situation". When he opened the Merrill Lynch account on July 29, 1981, Baghdady signed an agreement called a "Standard Option Agreement." The agreement provided that "[a]ny controversy between [Baghdady and Merrill Lynch] arising out of such option transactions or [the] agreement shall be settled by arbitration only before the National Association of Security Dealers. . . . "

In November, 19481, Baghdady met Larry D. Sadler and John Voll, two stockbrokers operating out of Merrill Lynch's

Burlington, Massachusetts, office with expertise in options trading. Believing that the Burlington office would better serve his needs and perhaps find a way to reduce the losses that had continued to escalate under Merrill Lynch's watch, in December, 1981, Baghdady directed Merrill Lynch to open an account in his name at the Burlington location. Merrill Lynch did so by transferring the trade balances in the Boston account to a newly assigned account at Burlington. Once at the Burlington office, a slightly different investment strategy was pursued although it still involved options trading against the Teledyne stock. Baghdady's misfortunes continued at the Burlington office and by the time he closed that account in 1982 his losses had mounted to $1,432,248.91.

On August 2, 1985, Baghdady brought this action against Merrill Lynch and Sadler, seeking damages for their alleged mishandling of his securities account. Merrill Lynch and Sadler moved to compel arbitration under the Federal Arbitration Act, 9 U.S.C. §§ 1-16. That motion was granted over Baghdady's objections and the case proceeded to arbitration before the National Association of Securities Dealers, Inc. (the "NASD"). On February 26, 1991, following an evidentiary hearing, a three-member NASD panel awarded Baghdady the amount of $60,720.15. Baghdady petitioned the District Court to vacate or correct the NASD award, but on January 14, 1992, the court confirmed the award. Baghdady has appealed challenging both the initial order to arbitrate and the final confirmation of the award.

The Decision to Combel Arbitration

The document that Baghdady signed on July 29, 1981, explicitly governed "any transaction" executed by Merrill Lynch for put and call options. It stated that "any controversy between us arising out of such option transactions . . . shall be settled by

arbitration. . . ." The document did not limit its terms to a particular account. Instead, its scope extended to all accounts the customer might have with Merrill Lynch.[1] The controversy here involves put and call options exercised by Merrill Lynch on behalf of Baghdady. It is thus clearly within the terms of the agreement to arbitrate. Baghdady asserts that he did not read the printed text of the document when he signed it, did not intend to enter into an arbitration agreement and did not intend that the agreement would apply to any other account. He likewise asserts that when he opened the Burlington account in December, 1981, he did not intend the July agreement to apply. Although these may be disputed matters, they are not material. The document Baghdady did sign was clear on its face and its scope was unrestricted.[2] There is no suggestion that Baghdady was prevented from reading the document before he signed it.

Baghdady argues that under this interpretation of the document, a new account opened 30 years later in Melbourne, Australia, would still be subject to arbitration. If the customer's relationship with Merrill Lynch was ongoing during the 30 years (as it was here during six months), that might well be the case.

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1. Paragraph 3, for example, provided: "Any securities and funds held by you in any account of mine with you shall be held by you as security for the performance by me of my obligations to you under this Agreement." Paragraph 8 also made clear that Merrill Lynch contract documents applied to more than one account: "Any agreement by me with you, whether previously or hereafter made applicable to any account of mine with you, shall also apply to such option transactions except to the extent which it conflicts with this agreement. In the event of a conflict, this agreement shall control, and where there is no conflict, each provision of each agreement shall apply."

2. Baghdady is bound by his "external expression of intention as distinguished from [any] undisclosed intention." *Restatement (Second) of Contracts* § 2 cmt. b (1981).

Neither in that case nor in this case do we have a situation where the contractual relationship has come to an end such that the parties might reasonably expect their legal agreement to have lost any continuing vitality. Instead, Baghdady transferred his stock directly from the Boston account to the Burlington account.

Baghdady also points to the language in *Par-Knit Mills, Inc. v. Stockbridge Fabrics Co., Ltd.*, 636 F.2d 51, 54 (3rd Cir. 1980), that "[i]f there is doubt as to whether [an express unequivocal arbitration agreement] exists, the matter, upon a proper and timely demand, should be submitted to a jury." The "doubt" in *Par-Knit*, however – and thus the genuine issue of material fact – was whether a company's production manager had authority to bind the corporation for which he spoke. There is no dispute here that Baghdady had authority to bind himself. Since we find the language clear in the contract he signed, there is no issue for a trial, jury or nonjury, under the Federal Arbitration Act, 9 U.S.C. § 4.

We conclude therefore that the district court properly ordered arbitration under the Federal Arbitration Act.

The Arbitration Award

The Federal Arbitration Act permits a district court to vacate an arbitration award where it finds certain wrongdoing or abuses in the arbitration process. 9 U.S.C. § 10. Baghdady has not asserted that any such statutory abuses have occurred here. Rather, he contends that the award should have been vacated because there was evidence of a "manifest disregard of the law," citing *Wilko v. Swan*, 346 U.S. 427, 436-37 (1953) (creating a judicial standard for reviewing arbitration awards outside the Federal Arbitration Act), *overruled on other grounds by Rodriquez de Quijas v. Shearson/ American Express, Inc.*, 490 U.S. 477 (1989).

Cut to its essence, Baghdady's claim is that the arbitrators fully understood established legal principles for calculating damages, but disregarded those principles. Baghdady insists that such disregard of the law is proven by the amount of damages actually awarded. He maintains that the $60,720.15 awarded was the"sum of [his] losses on precisely two transactions in the account." If that was the basis for the award, he argues, then there must have been a manifest disregard of the law because the arbitration panel could not justifiably have distinguished those two transactions from the losses demonstrated on "the 25 other transactions in his account." Baghdady's displeasure with his recovery, however, provides no basis for vacating the award. For us to find a manifest disregard of the law, "there must be some showing in the record, *other than the result obtained*, that the arbitrators knew the law and expressly disregarded it." *Advest, Inc. v. McCarthy*, 914 F.2d 6, 10 (1st Cir. 1990) (emphasis supplied) (citations omitted).[3] Here, Baghdady has nothing but the arbitration result to buttress his claim of manifest disregard. That is simply insufficient.

Advest left open one other additional possibility: "In certain circumstances, the governing law may have such widespread familiarity, pristine clarity, and irrefutable applicability that a court could assume the arbitrators knew the rule and, notwithstanding, swept it under the rug." *Id.* at 10. But like *Advest*, this is not such a case. As *Advest* recognized, "arbitrators possess latitude in crafting remedies as wide as that which they possess in deciding cases. . . . That leaway is at its zenith when, as here, the

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3. Baghdady also seeks to have us modify *Advest* to include "consideration of how the law was applied to the facts or otherwise to avoid a miscarriage of justice." We see no reason to do so. Such a modification would cut against decades of judicial treatment of arbitrators' decisions.

arbitration clause imposes no limitations on choice of remedies." *Id.* at 10-11 (citations omitted). Even if the award here was based on two specific transactions as Baghdady suggests, the panel may have found that the defendants had breached a promise to rescind those transactions. Baghdady argues that this finding would have been erroneous. That, however, is a matter beyond the scope of our review. As we have said before, we "do not sit to hear claims of factual or legal error by an arbitrator as an appellate court does in reviewing decisions of lower courts." *Advest*, 914 F.2d at 8 (*quoting United Paperworkers Int'l Union v. Misco, Inc.*, 484 U.S. 20, 38 (1987)). "[As] long as the arbitrator is even arguably construing or applying the contract and acting within the scope of his authority,' a court's conviction that the arbitrator made a serious mistake or committed grievous error will not furnish a satisfactory basis for undoing the decision." *Advest*, 914 F.2d at 9 (*quoting Misco*, 484 U.S. at 38). Whatever its reasoning, the panel's award here was at least within the realm of possible remedies that could have been fashioned in this case. The district court properly confirmed the awad.

Judgment *AFFIRMED.*

APPENDIX B – JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT DATED SEPTEMBER 9, 1992

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCIT

No. 92-1214

ELIE J. BAGHDADY,

Plaintiff, Appellant,

v.

LARRY D. SADLER, ET AL.,

Defendants, Appellees.

JUDGMENT

Entered: September 9, 1991

This cause came on to be heard on appeal from the United States District Court for the District of Massachusetts, and was argued by counsel.

Upon consideration whereof, it is now ordered, adjudged and decreed as follows: The judgment of the district court is affirmed.

By the Court,

FRANCIS P. SCIGLIANO
Clerk

APPENDIX C - MEMORANDUM OF THE UNITED STATES DISTRICT COURT, DISTRICT OF MASSACHUSETTS, DATED JANUARY 14, 1992

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

CA No. 85-3101-T #58

CA No. 91-11484-T#12

ELIE J. BAGHDADY,

Plaintiff,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., et al.,

Defendants

MEMORANDUM

January 14, 1992

TAURO, Ch.J.

Dr. Elie J. Baghdady petitions to modify or vacate an arbitration award which the defendants, Merrill Lynch, Pierce, Fenner & Smith, Inc., and broker Larry Sadler (collectively, "Merrill Lynch ") move to confirm. Baghdady lost approximtely $1.4 million in his account with Merrill Lynch. He sued, alleging violations of federal and state law. The dispute went to a panel of the National Association of Securities Dealers, which, after a six-day hearing, awarded Baghdady $60,720.15.

Appendix C

A.

An arbitral award will be vacated only if the arbitrators recognized the applicable law and ignored it; or, in other words, that they acted irrationally or arbitrarily. *Advest, Inc. v. McCarthy*, 914 F.2d 6, 9 (1st Cir. 1990). Baghdady must show something in the record, other than the result, that indicates that the arbitrators knew the law and expressly disregarded it. *Id.* at 10 (citation omitted).

The arbitrators do not need to explain their award, *id.*, and they did not do so here. As the First Circuit recognized, the absence of an explanation makes it extremely difficult for a petitioner, like Baghdady, to challenge an award. *See id.* (citation omitted). Baghdady succeeds, however, in identifying the award as equalling his losses "on precisely two transactions in the account." See Petitioner's Brief at 20. This in itself suggests that the award was rationally based, and not arbitrary. Baghdady argues that it was arbitrary, because the evidence did not permit the arbitrators to distinguish two out of twenty-five transactions. Merrill Lynch, however, points to record evidence that suggests that these two transactions were distinguishable from all other transactions, because Merrill Lynch had apparently agreed to rescind them. *See* Defendants' Memorandum at 9.

In any event, it is not Merrill Lynch's burden to show that the award was rational, but Baghdady's to point to record evidence of the arbitrators' manifest disregard of the law. Baghdady musters what he calls "undisputed evidence" of his losses and of Merrill Lynch's violations of its authority. But such "evidence" is a factual matter, and the court's role is not to hear allegations of factual error. *Advest*, 914 F.2d at 8 (citation omitted).

Appendix C

Baghdady also asserts that he should have been awarded prejudgment interest on the award but, again, does not show by what legal authority he was entitled to the interest. Arbitrators are entitled to craft remedies they deem appropriate. *Id.* at 10-11. Where there is no limitation on their remedial power, and none is apparent here, an award without prejudgment interest does not contravene any legal authority. Although M.G.L. c. 231 S 6C provides that prejudgment interest shall be awarded in contract actions, and although Baghdady's claim against the defendants was essentially contractual, "the arbitrators may have concluded that [his] entitlement was equitable, rather than contractual, and that therefore interest was discretionary." *Nicoletti v. E.F. Hutton & Co., Inc.*, 761 F. Supp. 312, 314-315 (S.D.N.Y. 1991) (noting that petitioner cited no case in which an arbitration award was vacated for failure to award prejudgment interest). *See also Oppenheimer & Co., Inc. v. Graziano,* No. 90-C6236, 1991 U.S. Dist. LEXIS 2101 at *2 (N.D. Ill. Feb. 21, 1991) (absent proffer of authority, petitioner not entitled to prejudgment interest).

B.

Merrill Lynch moves to confirm the award and to be given attorneys' fees, because, it says, Baghdady's petition is groundless. Although the award merits confirmation, Merrill Lynch does not show that Baghdady prosecuted this action in bad faith, so as to justify a discretionary award of fees. *See Brigham & Women's Hosp. v. Massachusetts Nurses Ass'n*, 684 F. Supp. 1120, 1125 (D. Mass. 1988).

An order will issue.

s/ J.F. Tauro
United States District Judge

APPENDIX D — ORDER EXTENDING TIME OF THE SUPREME COURT OF THE UNITED STATES DATED NOVEMBER 20, 1992

SUPREME COURT OF THE UNITED STATES

No. A-406

Elie J. Baghdady,

Petitioner

v.

Larry Sadler, et al.

ORDER

UPON CONSIDERATION of the application of counsel for the petitioner,

IT IS ORDERED that the time for filing a petition for a writ of certiorari in the above-entitled case, be and the same is hereby, extended to and including February 5, 1993.

D.H. Souter
Associate Justice of the Supreme
Court of the United States

Dated this 20th day of November, 1992.

APPENDIX E — RELEVANT STATUTES

9 U.S.C. § 3:

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 4:

Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28 [28 USCS §§ 1 et seq.], in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order

directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure [USCS Rules of Civil Procedure]. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, expect in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure [USCS Rules of Civil Procedure], or may specially call a jury for the purpose. If the jury find that no agreement in

writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

9 U.S.C. § 10:

§10. Same; vacation; grounds; rehearing

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration–

(1) Where the award was procured by corruption, fraud, or undue means.

(2) Where there was evident partiality or corruption in the arbitrators, or either of them.

(3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the

rights of any party have been prejudiced.

(4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

(5) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators.

(b) The United States district court for the district wherein an award was made that was issued pursuant to section 590 of title 5 may make an order vacating the award upon the application of a person, other than a party to the arbitration, who is adversely affected or aggrieved by the award, if the use of arbitration or the award is clearly inconsistent with the factors set forth in section 582 of title 5.